The Role of

PRICE DETERMINATION AND REGULATION

through

Federal Milk Marketing Agreements and Orders

and

State Milk Control Activities

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PRICE DETERMINATION AND REGULATION

Federal Milk Marketing Agreement and Order Program

Since 1932-33, milk producers have put increasing reliance on Federal and State governmental milk pricing programs as a means of establishing minimum price levels. Beginning with the Agricultural Adjustment Act of 1933, the United States Department of Agriculture has carried out a continuous program of fixing minimum prices for milk delivered by producers to many of the urban centers of the country. Under the Agricultural Adjustment Act of 1935, the Department's authority in connection with the fixing of minimum prices for milk was expanded and made more explicit, as compared with the 1933 enactment. Additional authority and further clarification of the status of milk control legislation was achieved through the passage of the Agricultural Marketing Agreement Act of 1937 - the statute under which the present program of milk price fixing is carried out.

Objectives

The purpose of the Federal milk marketing order program is to attain four main objectives. These are: (1) To provide stable and dependable markets for farmers who sell milk in city markets primarily for consumption in whole fluid form; (2) to regularize competition among handlers in the procurement of milk from farmers; (3) to assure consumers of adequate and dependable supplies of pure and wholesome milk; and (4) to provide an efficient mechanism which will operate in the public interest for establishing minimum prices to farmers for milk sold in city markets.

These objectives are achieved by fixing minimum prices for each use of milk, which prices are uniform among handlers, and by providing for uniformity of returns to producers, subject only to differentials for variations in butterfat content and location at which milk is delivered. The public procedures of hearing and publication of facts and conclusions on which regulatory decisions are based affords opportunity for public participation in the price making decisions and helps assure that such decisions will be taken in the public interest.

Federal milk orders are one part of a two-pronged program of governmental aid to the dairy industry. The Federal order program is designed primarily to aid farmers who produce milk for fluid consumption in city markets. It necessarily must be related to, and even dependent upon, the other part of the program, i. e., the price support activities with respect to milk and butterfat produced for manufacture into dairy products. It has been found that, generally speaking, all segments of the dairy industry are related. Consequently, the prices which may be fixed under the milk order program must bear an appropriate relationship to the prices for milk and

butterfat produced for manufacture into dairy products. To the extent that manufacturing milk and butterfat prices are influenced by the price support activities of the Department, that influence also will be carried through in returns to producers who sell their milk in Federally regulated markets.

Form and Scope of Regulation

Because a Federal milk order deals with a complex and ever changing industry, the regulation itself is very complicated and detailed. An order specified an individual marketing area wherein the handling of all fluid milk will be regulated. It defines handlers and producers and other terms which are necessary for precision and clarity. It sets forth a classified use plan for pricing milk and the minimum prices to be paid for milk for each class use. As an adjunct of the classified pricing plan, a pooling method also is provided.

An agency known as a market administrator is set up to administer the order in a local area. An assessment is levied against regulated handlers to defray the expenses necessarily incurred by the market administrator. A detailed verification and auditing system is set up and every milk handler is audited regularly on each month's business. The purpose of this audit is to verify the accuracy of the reports of each handler on his receipts and utilization of milk and to insure that each producer has been paid at least the uniform price. The market administrator also furnishes general statistical information about marketing and pricing conditions in the regulated area. It is necessary, therefore, for the market administrator to provide a staff of trained accountants and statisticians to carry out his assigned functions.

At the present time, orders are effective in 52 marketing areas. These areas range in size and importance from New York, Boston, Philadelphia, Chicago, and Detroit to the smaller ones like Paducah, Kentucky, and Southwest Kansas. In 1953, the orders regulated about 30 percent of the milk produced for use as milk and cream in the United States. About 183,000 producers delivered to regulated handlers about 26 billion pounds of milk, with a value of about $1,125,000,000 during that year.

Since essentially all that the Agricultural Marketing Agreement Act of 1937 authorizes the Secretary to do with respect to milk is to fix the minimum prices which handlers are required to pay for milk received from producers, the order program is necessarily limited in scope. The Secretary may not specify the producers from whom a handler shall purchase milk nor how much he shall purchase. A producer is free to sell his milk in a regulated market if he can find a buyer for it. All that a milk order does is require that if a handler

receives milk from a producer, he must pay the minimum prices for it. The order program, because of its limited scope, obviously, cannot guarantee that farmers will always have markets for their milk or that the prices which they receive under the program will always be satisfactory.

The Classification and Pooling of Milk

The most important tools used in Federal milk orders to maintain marketing and pricing stability are the payment of minimum prices through the technique of the classified use plan and the pooling of returns to producers. The advantage and strength of the classified use plan is that minimum prices for milk may be made equal among handlers according to use, that a price may be fixed for the milk utilized as Class I at a level that will bring forth an adequate supply of pure and wholesome milk, and that a necessary reserve of milk may be maintained at all times (and disposed of at prices in line with its value when processed into manufactured dairy products) without at the same time unstabilizing the price structure for Class I milk. The pooling provisions insure that each producer receives a price uniform with that paid other producers and thereby ameliorates the effects of uneconomic shifting by producers among markets.

The "classified price plan" and various pooling arrangements were first developed by producer cooperative associations during the period from 1914 to 1930. Although these methods became fairly well established as an industry pattern at that time, they tended to break down because of the inherent advantages which accrued to producers and dealers who refused to participate in the plans. Dealers who refused to participate in the plan usually purchased milk from nonmember producers on a flat price basis at prices that were the same or even slightly higher than the blended prices returned to producer members by the cooperative associations. The dealers, in turn, usually purchased only enough milk to supply their fluid requirements, which made the net cost of milk to them substantially lower than the Class I price negotiated by the producers' cooperative. The fact that noncooperators could easily nullify the efforts of the cooperatives was a serious weakness in the fluid milk marketing structure of that time, although it did not become too apparent until the early 1930s. Federal milk orders offset this weakness by assuring that all dealers pay for milk according to the classified price plan operative in an area.

Federal milk orders establish a classification plan by specifying the various uses for milk and assigning them a classification number. Milk sold as fluid milk for milk and fluid milk drinks, for example, is usually placed in Class I. Milk used as cream may be in Class I or II, the particular class depending on local conditions.

Production that goes into ice cream, butter, or cheese is placed in Classes II, III, or IV, depending on the complexity of the marketing structure in each regulated area. These classification plans are based upon the situation that exists generally in fluid milk markets. First of all, the demand for fluid milk varies quite widely from day to day. Production of milk also varies. Because fluid milk is so highly perishable and nonstorable and has higher quality standards than manufacturing milk, distributors must have a daily reserve of such milk to meet the varying demands of consumers. Secondly, these reserve supplies of milk for the most part are used by being processed into manufactured dairy products, which sell at the same prices as when made from milk of manufacturing quality. The classification plan meets this situation by establishing one minimum price for milk used for fluid purposes and a lower minimum price for milk diverted to lower use (manufacturing milk) classes.

Uniform Prices to Producers

Because different prices apply to milk disposed of in the several uses, a method of distributing moneys among producers is necessary in order to achieve uniformity of returns. The Act affords a choice of two methods of pooling returns to producers. One is the market-wide pool, the other is the individual handler pool. Under a "market-wide" pool, the total money value of all milk delivered by all producers (pounds of milk in each class, multiplied by the minimum class prices and usually adjusted for certain differentials or deductions) is divided by the total amount of producer milk to be priced. Then all producers are paid the same "uniform," or blended, price a hundredweight for their milk shipments, adjusted for butterfat variations and other specified differentials. With an "individual handler" pool, the same computations are made in arriving at each handler's value of milk, and all producers supplying the particular handler are paid the same "uniform," or blended, price a hundredweight (which also may be adjusted for butterfat variations and other specified differentials). Under the latter pool, producers of milk of the same grade and test supplying one handler receive a uniform price which may differ from those paid producers supplying other handlers in the market if the handlers differ in the proportion of milk used in the different classes.

Minimum Class Prices

The main feature of a milk order is the fixing of minimum prices payable by handlers to producers. The standard of the Act, therefore, which determines the level of prices which may be fixed in milk orders is a most important one. The Act provides that producers' milk prices shall be fixed at levels which will "reflect the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk or its products in the marketing area . . . (and which will) . . . insure a sufficient quantity of pure and wholesome milk and be in the public interest."

The important point of this standard is that it provides only that prices shall be such that over a reasonable period, and after taking into account the need for a reserve of milk and seasonal variation in production, the supply of milk which meets the quality standards of the market will be about equal to the needs of the market for milk of that quality. In other words, the standard provides for prices which will tend to equate supply and demand in the market. This means that the milk order program can relate milk prices to general economic conditions but it cannot maintain them out of line with such conditions. The Secretary is required to determine parity prices for milk in connection with the issuance of milk orders. However, because of the more specific price standards which have been provided for milk, parity has not been an important determinant of prices since the enactment of the present legislation.

Each order then sets forth the minimum price or a formula for determining the minimum price for each class of milk. Although the price for milk in any manufactured class is always tied to the price for manufactured dairy products or fluid cream or prices paid farmers for milk used in such products, the formulas for determining the price of Class I milk vary widely from market to market. The price levels, generally, are set by means of price formulas which allow the minimum prices to change automatically along with certain changes in the market conditions for fluid milk. This is done because conditions which affect milk prices change frequently and rapidly. Every season of the year brings substantial changes which would soon render a fixed, flat price out-of-date.

Class I price techniques. Originally, the orders established a specific Class I price which was left unchanged until formal amendment action was taken. Subsequently, various automatic devices have been adopted. These have kept Class I prices more closely and promptly adjusted to changing economic conditions and have also reduced the number of amendment hearings. In the great majority of the Federal orders, the automatic devices consist of a premium over a "basic formula price" which measures the value of milk used for the major manufacturing purposes. In any particular order, the amount of the premium over the basic formula price (usually referred to as the "Class I differential") depends upon local conditions of supply and demand. In the New England, New York, Philadelphia, and New Orleans markets, the automatic device is an economic formula, rather than the basic formula manufacturing prices. The New York formula consists of a base period price adjusted by changes in the index of commodity prices at wholesale. In the other markets, the economic formulas include cost factors and measures of consumer purchasing power. In San Antonio, an economic formula has been superseded by the basic formula pricing of the North Texas order.

In recent years, supply-demand adjustments have been included in the Class I price provisions of the majority of both types of orders.

These adjustments raise the Class I price whenever a shortage of milk is indicated and lower prices whenever an over-supply develops. Unfortunately, the supply-demand adjustments are not as good advance forecasters as we might wish. Ideally, we should like to use such factors as cow population, feed prices, weather data, and consumer purchasing power, to indicate the prospective status of supply and demand. In the absence of reliable forecasts of this type, supply and sales data in the preceding few months are used as the indicator of current conditions. In view of the shortcomings of such a device, maximum and minimum limits are normally applied and a change of several points in the supply-demand ratio is required before any price change results. Despite these limitations, the supply-demand adjustments have proven very useful to the program. Generally speaking, they increased the Class I differentials in late 1951 when most markets were short of milk, reduced prices beginning in late 1952 through the summer of 1954 when milk production nationally has been at a high rate, and have increased prices in recent months as shortages have developed.

Level of surplus prices. We have already noted that milk which cannot be used for fluid purposes is diverted to manufacturing uses and is priced accordingly. However, the particular price which is applied to these seasonal and daily excesses is of greater importance than is generally recognized. In many markets, a cooperative association or one or two proprietary handlers handle the bulk of the excess milk. All handlers are affected to some extent, however, since they must either handle their own excesses or dispose of such milk to other plants. The order prices determine the profitability of manufacturing excess milk and this, in turn, determines whether or not handlers are willing to add more producers than are actually needed for fluid purposes.

Seasonal Pricing Plans

Several plans are employed for obtaining a more even pattern of milk deliveries throughout the year. One plan is known as the "base-rating" or "base and excess" plan. Other techniques used for this purpose are the "Louisville" or "take-out and pay-back" plan and a system of seasonal differences in the Class I price differentials.

The problem. The seasonal problem arises from the fact that the demand for fluid milk is essentially the same in all months of the year, while production conditions are most favorable in the spring months. A supply which is adequate to fill the bottles in November commonly results in a considerable over-supply in the spring months, and the seasonal excess must be used for manufacturing purposes. By reducing the spring flush, the inefficient handling of excess milk can be minimized. The problem peculiar to the fluid milk industry in this connection results from the fact that only the seasonal excess

is manufactured; a strictly manufacturing plan also faces a seasonal supply, but the peak volume may be only twice or three times as high as the lowest volume instead of infinitely higher.

Equity between producers is as important a seasonal problem as is the physical disposal of the seasonal excess. If no seasonal pricing device is used, the blend price in November will be up close to the Class I level since virtually all of the producer milk will be used in the bottle. In the spring, however, the blend will be reduced by the large quantities which must be sold at the manufacturing class price.

Techniques. The base-rating plan gives each individual shipper a base equal to his daily average fall season deliveries. Then, in the ensuing flush season, he gets approximately a Class I price for a quantity equal to his base and a manufacturing price on any excess milk he delivers.

More of the orders rely on seasonal changes in the Class I differential to encourage level production than on any other device. The flush season Class I differential can be reduced to the point where the blend price at the outer edge of the milkshed is down at the level of manufacturing milk values. The short season differential is correspondingly higher, with the result that the level producer gets a higher proportion of the price advantage over the manufacturing price level.

The Louisville plan is essentially a seasonal pricing device. However, it does not change the Class I price to distributors. Instead, it reduces the spring blend price to producers and adds the money so collected to the short-season blend price.

Results. It is not clear which of the three major plans for encouraging level production is most effective. The educational effort spent on any one of them is fully as important as the mechanics of the plan. In fact, the degree to which a distributor demands level production of his shippers as the price of being signed on or kept as a patron may be more effective than any of the techniques described above.

Marketing Areas

Principles. It should be emphasized that the territories defined in the Federal orders are the areas in which milk is sold to consumers, not the areas of production. In many instances, markets (such as New York and Boston, for example) may be quite separate so far as competition in sales to consumers is concerned, yet their milksheds may overlap to a significant extent. The marketing areas are defined primarily in terms of competition among distributors and similarity of

price influences. Fluid milk distribution is becoming more widespread in terms of delivery distances from bottling plants. The introduction of the paper bottle had reduced materially the cost of transporting milk for consumer packages and made it possible for this expansion of sales areas. Designated regulated marketing areas have necessarily been extended in order to meet this new situation.

Examples. Some very extensive marketing areas have been defined in orders. Within the past few years, such examples as North Texas, Central West Texas, Puget Sound, and the Neosho Valley markets come to mind.

In the same period, however, Federal orders have been promulgated in markets which are too small to support a complete administrative staff of their own but which are close enough to be administered by a previously existing staff in a larger market. Examples include Muskegon, Michigan; Fort Smith, Arkansas; Sioux Falls and Black Hills, South Dakota; Central Mississippi, and Central West Texas markets.

Manufacturing - Fluid Milk Price Relationships

As we pointed out above, all segments of the dairy industry are rather closely interrelated and are becoming more so. For this reason, prices under the Federal orders must be maintained in appropriate relationship to the prices for milk of manufacturing quality and to the prices of manufactured dairy products. We have shown above the techniques employed in maintaining these relationships.

Questions can and have arisen, however, as to what constitutes an "appropriate relationship." Some persons whose interest lies primarily with the manufacturing segment of the dairy industry have complained that the prices maintained under the order program have been too high, and that surpluses of milk have been accumulated which must be converted into manufactured dairy products, which further complicated the problems of the manufacturing segment of the industry. They have also complained that the order program is sometimes used to exclude milk from manufacturing areas entering the regulated fluid milk markets.

Federal milk orders operate in the Twin Cities and Chicago marketing areas. These markets are in the very center of the manufacturing milk areas. The prices applicable to milk under the orders have been adjudged appropriate in these two markets even by the most severe critics of the Federal order program. The prices in these markets, therefore, may be taken as bench marks from which to judge other prices under the orders. Recently, studies were made of the prices prevailing in the largest marketing areas of the East and

South under Federal regulation, and it was shown that the average prices for Class I milk in these markets were not more, except in one instance, than the Chicago or Twin Cities price, plus the cost of transporting milk from Chicago or Twin Cities to the regulated markets being studied. It was clear that for the most part the reason that shipments of milk from Midwestern areas to distant Eastern and Southern markets were not being made was that the prices in the Eastern and Southern markets were so low in relation to Midwestern Class I prices, that making such shipments would be uneconomic. The one exception found in this study was the New Orleans market where the Class I price was higher than the Chicago Class I price, plus transportation to New Orleans. No shipments were being made to this market from Midwestern sources at that time. There were, however, no provisions of the Federal order in the New Orleans market which in any way hindered or inhibited such shipments. Apparently, they were not being made because the price disparity was thought to be a temporary one. More recently, milk supplies in Southern areas have become shorter and shipments are now being made, more or less, regularly from Midwestern sources to Southern markets.

Questions have also been raised concerning the need and purposes of pool plant and compensatory payment provisions of the Federal orders. These provisions have been said to exclude milk from distant sources from regulated markets. The fact is that pool plant provisions and the corollary compensatory payments are based on performance standards which are equal for all plants without regard to their location. Any producer may sell his milk in a Federal order market if he can find a buyer for it. Any plant, insofar as the milk orders apply, may ship its milk to a regulated market. If a plant makes sufficient shipments to meet the pool plant standard, it will become fully regulated and will share in the pool equally with other regulated plants. If it does not make sufficient shipments to become fully regulated, it may be required to make compensatory payments in order to remove the advantage it would otherwise have in shipping unregulated milk into a regulated market. In any case, whether it becomes fully regulated will depend upon the decision of the plant owners, for any plant no matter where located may become fully regulated under any Federal order if it will operate in accordance with standards prescribed by the order which apply equally to all plants without regard to their location with reference to the marketing area.

Procedures for the Issuance of Minimum Price Orders for Milk

The United States Department of Agriculture undertakes work on a milk pricing regulation upon receipt in the Department of an application for a Federal milk marketing agreement and order accompanied by a detailed proposal for such a regulation. This request for Federal assistance ordinarily is furnished by a cooperative association of producers which is interested in milk regulation for a particular market.

Upon receipt of an application for regulation, an investigation of the market and its problems may be made. The purpose of this investigation is to ascertain preliminarily: (a) Whether the problems sought to be corrected by the proposed marketing agreement and order are ones which may properly be dealt with by Federal regulation; (b) the extent of interstate commerce in the market; (c) the availability of information and statistics regarding the marketing and pricing of milk, and (d) whether in light of the preliminary information the proposed marketing agreement and order would seem to correct the conditions sought to be corrected and whether it would tend to effectuate the declared policy of the Act.

If the investigation discloses the availability of sufficient information, the feasibility of issuing an order, and an indication that an order would tend to effectuate the declared policy of the Act, a hearing is held in the area where the contemplated regulation will apply. The purpose of the hearing is to afford all interested persons an opportunity to present facts and evidence regarding (1) the desirability and feasibility of issuing a marketing agreement and order and (2) the particular terms and conditions which the regulation, if issued, should contain.

At the close of the hearing, interested persons are given an opportunity to file briefs on the issues and subject matter of the hearing. If the evidence of the record supports the issuance of an order, the recommended decision contains a statement of the need for an order, the extent of interstate commerce, and the evidence and reasons which underlie each of the terms and conditions of the recommended order. The recommended order shows the detailed provisions of the proposed regulation. The purpose of the recommended decision and order is to give a preliminary view of the Department's appraisal of the facts and evidence of the hearing record and of the particular terms and conditions which the Department believes should be contained in the regulation.

Interested persons may file exceptions to the recommended decision and order and, on the basis of these exceptions and a further review of the hearing record, a final decision and order are prepared. This final decision states facts, evidence, and reasons for each of the provisions of the marketing order. The milk price order in its final form is issued (but not made effective) at the same time.

Marketing orders may be made effective only if producers shipping to handlers in the area approve or favor the order. A referendum is usually held to determine whether producers favor an amendment to an order and are always held to determine whether they approve a newly issued order. The referendum is held under the supervision of a referendum agent. If it is determined that producers in requisite number favor the order, a further notice is issued making the order effective as of a specified date.

State Activity in Milk Price Regulation

Since 1932-33, individual states have also engaged in milk price fixing activities. At the present time, 17 states have programs that regulate the price of milk in some way. Four of the states engaged in "milk control" fix only the prices paid to producers; the other states also fix prices for milk sold at wholesale and retail by handlers.

Although the activities of the states with respect to milk control are generally similar to the activities of the Federal government in that both fix prices payable to producer, there are important differences in the powers and types of regulatory tools used. Federal milk marketing agreements and orders are based on the power of the Federal government to regulate commerce among the states. As a result, it is possible to cover under Federal regulation all of the milk which is produced for sale in a particular marketing area without regard to the fact that the milk may cross state lines in transit from the point of production to the place of consumption. Whenever it is necessary to do so, therefore, a milk order may be applied to the whole milk supply of a market. This is one of the advantages of Federal regulation, especially in any market where considerable proportions of milk come from other states.

The standards used in fixing producers' prices also are considerably different in some of these states, as compared to the Federal standard. Such factors as cost of production and reasonable returns on investment are used as guides by some state agencies in fixing producer prices. As noted above, most state agencies also fix resale prices, an activity not authorized by the Federal statute. It is clear that the techniques and statutory objectives of the state milk control activities differ considerably from the techniques and objectives of the Federal statute.

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